ISSUE DATE: August 11, 1997

DOCKET NO. G-011/M-96-1407

ORDER APPROVING REQUEST FOR CHANGE IN DEMAND ENTITLEMENTS

BEFORE THE MINNESOTA PUBLIC UTILITIES COMMISSION

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| Edward A. Garvey | Chair |
| Joel Jacobs | Commissioner |
| Marshall Johnson | Commissioner |
| Don Storm | Commissioner |

In the Matter of a Request by Peoples Natural Gas Company, a Division of UtiliCorp United, Inc., for a Change in Demand Entitlements

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## PROCEDURAL HISTORY

On November 12, 1996, Peoples Natural Gas Company, a Division of UtiliCorp United, Inc., (Peoples or the Company) filed a request to change its demand entitlements, pursuant to Minn. Rules, part 7825.2910, subp. 2. The Company also asked to implement a miscellaneous rate change, pursuant to Minn. Rules, part 7825.3100, subp. 9, and part 7825.3200.

On January 13, 1997, the Department of Public Service (the Department) filed comments.

On February 3 and 4, 1997, Peoples filed reply comments.

On February 13, 1997, the Department filed a response.

On July 17, 1997, the Department filed a further response regarding the Company's future use of penalty gas as part of its gas procurement strategy.

The matter came before the Commission for consideration on July 8 and July 31, 1997.

## FINDINGS AND CONCLUSIONS

### I. INTRODUCTION AND FACTUAL BACKGROUND

Peoples requested a number of changes to its gas service portfolio, including an increase in the amount of design day pipeline transportation capacity for which Peoples' Minnesota customers must pay. Under the proposal, the increase would occur in two stages: phase one, in the November, 1996 Purchased Gas Adjustment (PGA); and phase two, in the December, 1996 PGA.

While the Department recommended approval of the Company's proposed increase in demand entitlements, the Department questioned Peoples' reliance on overrun, or penalty, gas as part of its overall supply. After further analyzing Peoples' gas supply strategies, the Department recommended capping Peoples' recovery of Daily Delivery Variance Charges.

The Commission will discuss these issues in turn.

## II. PEOPLES' PROPOSED INCREASE IN DEMAND ENTITLEMENTS

### A. The Proposed Increase; Parties' Comments

Peoples' proposed change in demand entitlements would increase the amount of design day pipeline transportation capacity for which Peoples' Minnesota customers must pay. The two-phase increase would occur through the PGA in November, 1996, and December, 1996.

Under the Department's analysis, which included several corrections to Peoples' calculations, Peoples' proposal would increase the demand rate for General Service (residential) customers by $.0608 per Mcf, for an average of $7.00 per year. The increase for small and large volume firm customers would be higher.

The Department recommended that the Commission approve Peoples' filing, as corrected, and also approve the effective PGA recovery dates of November 1 and December 1, 1996.

Peoples did not dispute the Department's recommended corrections.

### B. Commission Action

Peoples' filings indicate that reliability should increase with the increased demand entitlements. The projected rate increases are reasonable in light of the increased system reliability. The Commission also notes that the Company successfully used the same gas supply arrangement in 1995-96.

For these reasons, the Commission agrees with the Department that Peoples' request for a change in demand entitlements, with the Department's corrections, is appropriate and should be granted.

## III. THE DEPARTMENT'S PROPOSED CAP ON RECOVERY FOR DDVC COSTS

### A. Factual Background

Daily Delivery Variance Charges (DDVC) are penalties that Northern Natural (Northern), one of the interstate pipelines that transports gas for Peoples, charges its local distribution company customers for taking more or less gas than they had scheduled. The penalties serve various purposes: they encourage customers to carefully plan and schedule their use of the interstate pipeline; and they discourage shippers from diverting supplies intended for receipt points on Northern's system to higher-priced, spot markets in other parts of the country. The penalties may also encourage capacity-deficient shippers to purchase more pipeline entitlement.

Peoples has previously relied on "penalty" or "scheduling charge" gas as a major means of meeting peak-demand during extremely cold weather. The Company has reasoned that purchasing penalty gas, while keeping its capacity reserve margin negative, is a better choice than building propane-air peak-shaving or LNG storage facilities, or purchasing a significant amount of additional pipeline capacity. Peoples is especially reluctant to build peak-shaving or storage facilities because it serves mostly low-density, scattered communities that do not offer the necessary economies of scale.

Peoples incurred approximately 75% of all the DDVC penalties levied against local distribution companies (LDCs) in Minnesota in the last heating season.

During the 1996-97 heating season, Northern received Federal Energy Regulatory Commission approval to charge higher DDVC penalties on "critical days." (Critical days, which may be called by Northern under tariff parameters, are periods in which severe weather or other circumstances jeopardize the safe and reliable operation of the pipeline.) Under some conditions, penalties for overruns will increase from $8.75/Mcf to as much as $113/Mcf.

The increase in Northern's DDVC rates prompted the Department's further investigation of Peoples' gas supply portfolio policies.

### B. The Department's Proposed DDVC Cap

In its written comments, the Department stated that Peoples' practice of trading higher DDVCs for lower demand costs may no longer be cost-effective under Northern's higher penalty rates. To prevent Peoples' customers from paying higher rates under the new DDVC charges than they would if Peoples had positive reserve margins, the Department suggested a cap on the amount of DDVC charges for which Peoples could recover through the 1996-1997 PGA true-up.

The Department recommended that the cap be set by calculating the cost to Peoples' customers if Peoples had a five percent reserve margin and incurred DDVC costs at the highest level incurred by any non-UtiliCorp company (i.e. $55,625). Applying the Department's method, the cap would be set at $1.55 million for 1996-1997.

At the July 8, 1997 hearing, the Department noted that the 1996-1997 heating season had passed without Northern's calling any critical days, or Peoples' incurring associated DDVC penalties. The Department's proposed cap on recovery for DDVC costs in the 1996-1997 season was therefore moot.

The Department stated that, during the development of Peoples' 1997-1998 gas portfolio, Peoples should look carefully at the issues the Department had raised. The Department recommended that Peoples reevaluate its gas procurement strategies as necessary, particularly noting Northern's greatly increased DDVC rates. The Department recommended that the Commission provide guidance for Peoples' future gas procurement strategies. The Department asked the Commission to indicate that the Department's proposed recovery cap of $1.55 million may be a good starting point for evaluating the Company's use of penalty gas.

In supplemental written comments dated Jul 17, 1997, the Department recommended that the Commission provide some guidance regarding Peoples' future use of penalty gas. The Department recommended that the Commission note that an LDC's use of penalty gas as a procurement strategy will be reviewed for prudence, on a case by case basis.

### C. Peoples' Reply Comments

Peoples objected to the Department's proposal to cap recovery for DDVCs. Peoples stated that the Department's proposal would allow ratepayers to receive the cost savings of approximately

$2.3 million from Peoples' negative reserve margin in 1996-1997, while shifting the associated economic risks to Peoples. According to Peoples, the Department's plan would violate the regulatory contract which allows Peoples to recover the cost it incurs in providing utility service. Peoples also noted that its capacity portfolio reflects a supply strategy previously approved by the Commission in Docket No. G-011/M-95-1145.[1]

If the Commission prefers the certainty of the higher cost capacity because of the risk associated with DDVCs, Peoples stated that it should be directed to take all reasonable available actions to obtain addition capacity. In such a case, Peoples argued, it would be entitled to recover the additional costs associated with the additional capacity.

After the Department filed its supplemental reply comments regarding the use of penalty gas as a gas procurement strategy, Peoples informally noted that it did not object to the Department's recommendations.

### D. Commission Action

The parties have agreed that the Department's recommendation of a cap on PGA recovery for 1996-1997 DDVC costs is moot. The 1996-97 heating season has passed without the Company's incurring any critical day penalty, so the proposed limit on recovery is no longer at issue.

Questions remain as to what, if any, guidance the Commission should provide regarding the Company's future gas procurement strategies.

The Commission will not order Peoples to make any changes to its gas procurement strategies at this time. In most cases, the Commission does not attempt to manage a utility's gas supply program. Each LDC is responsible for formulating and implementing its own gas procurement strategies, keeping in mind its system needs, and the risks and costs associated with each option. It is up to the company to follow a reasonable and prudent procurement policy, keeping in mind that its costs will ultimately be subject to prudence review. If an LDC chooses to use penalty gas as part of its procurement strategy, the company should be aware that the Commission will look closely in each case at the money paid in penalties, in light of the particular LDC's system circumstances.[2]

While the Commission does not see the need to order immediate changes in Peoples' gas policy, the Commission nevertheless agrees with the Department that Peoples must adjust its gas supply

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[1] In the Matter of a Request for Approval by Peoples Natural Gas Company, a Division of UtiliCorp United, Inc. to Change Its Portfolio of Capacity Services Used to Serve Its Customers Directly Connected to and Served by Northern Natural Gas Company Pipeline System, July 10, 1996.

[2] This Commission finding is consistent with the Department's July 17, 1997 recommendation regarding guidance for the future use of penalty gas, to which Peoples did not object.

strategies to meet the changes in the industry, or risk disallowance of a portion of its costs.

The Commission will therefore require Peoples to reevaluate its gas procurement strategies on an ongoing basis as needed, with particular attention to new developments and significant changes in the industry, such as Northern's higher DDVC rates. In this time of change in the gas industry, Peoples' ongoing reevaluation of its gas portfolio and procurement strategies will afford the Company the greatest opportunity to continue providing reliable and affordable gas supplies.

## ORDER

1. The Commission approves Peoples' November 12, 1996 filing, with the Department's corrections to calculations.

2. The Commission requires Peoples to reevaluate its gas procurement strategies on an ongoing basis as needed, as discussed in the text of this Order.

3. This Order shall become effective immediately.

BY ORDER OF THE COMMISSION

Burl W. Haar
Executive Secretary

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